

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
February 12, 2015**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:01 a.m. on Thursday, February 12, 2015, in Room #1-100 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. All members of the committee were present, as follows:

Presiding: Pat Hardy, chair; Lawrence A. Allen, Jr., vice chair; David Bradley; Ken Mercer; Thomas Ratliff

Public Testimony

This item provides an opportunity for the public to present testimony at the time the related item comes up for committee discussion or action. The procedures for registering and taking public testimony at State Board of Education committee meetings and general board meetings are provided at [http://tea.texas.gov/About TEA/Leadership/State Board of Education/SBOE Meetings/SBOE Operating Rules Amended 1 30 13/](http://tea.texas.gov/About_TEA/Leadership/State_Board_of_Education/SBOE_Meetings/SBOE_Operating_Rules_Amended_1_30_13/) or in the information section (yellow pages) of the agenda.

The Committee on School Finance/Permanent School Fund received no presentations of public testimony.

ACTION ITEMS

- 1. Election of Chair**
(No Agenda Exhibit)

The committee reelected Ms. Hardy as chair of the State Board of Education Committee on School Finance/Permanent School Fund.

- 2. Proposed Amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures**
(Second Reading and Final Adoption)
(Board agenda page III-1)
[Official agenda item #10]

David Marx, director of the office of school finance division of financial compliance, presented this proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures. The proposed amendment would clarify the requirements for a school district to hire an independent auditor to conduct an audit and give an opinion on the annual financial and compliance report of a school district, governmental charter school, open-enrollment charter school, not-for-profit service provider, county education district, or regional education service center. The proposed amendment would also move the auditors' requirements, which are

currently dispersed in various locations in the *Financial Accountability System Resource Guide (FASRG)*, into a single location to make them easy to find. The existing provisions in the rule would be edited slightly for plain language.

Mr. Marx stated that all public comments received addressed the mandate to change auditors every five years, which has been removed from the proposed amendment. Mr. Ratliff clarified that the Texas Education Agency could still require a mandatory change of auditors if certain flags were raised.

MOTION AND VOTE: *It was moved by Mr. Mercer, seconded by Mr. Bradley, and carried unanimously to recommend that the State Board of Education, by an affirmative vote of two-thirds of the members of the board, approve for second reading and final adoption the proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures, with an effective date of 20 days after filing as adopted with the Texas Register.*

DISCUSSION ITEM

3. Review of Permanent School Fund Securities Transactions and the Investment Portfolio (Board agenda page III-19)

Catherine Civileto, deputy executive administrator, provided a summary on the status of the Permanent School Fund portfolio. Reports presented to the committee were for the reporting period October 1 through December 31, 2014 unless otherwise noted. Ms. Civileto's report included reporting on the current fair market value of the Fund, the asset allocation mix as of December 31, 2014, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period October through December 31, 2014 and the fiscal period beginning September 1 through December 31, 2014, the activity on the securities lending program for the fiscal period September 1, 2014 through December 31, 2014, the status of transfers from the General Land Office as per the resolution they agreed to for the current fiscal year, current status of the Bond Guarantee Program and the available capacity in the program, internal fixed income credit rating changes, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2014 through December 31, 2014, and short-term cash investments.

CONSENT ITEM

4. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of October, November, and December 2014 (Board agenda page III-9) [Consent agenda item #(3)]

MOTION AND VOTE: *Based on the information provided by staff and the recommendation of the executive administrator and chief investment officer and the commissioner of education, the committee recommended by unanimous consent to ratify the purchases and sales for the months of October, November and December, 2014 in the amount of \$1,210,171,245 and \$1,245,039,259, respectively (Attachment A).*

DISCUSSION ITEMS

5. Annual Reporting Requirement of the Internally Managed Permanent School Fund Investment Portfolio

(Board agenda page III-21)

Holland Timmins, executive administrator and chief investment officer, provided the required attestation regarding the compliance with 19 TAC Chapter 33 of the internally managed investment portfolio in the matters of permissible and restricted investments, trading and brokerage policy, and proxy voting policy.

6. Report by the State Auditor's Office on the Audit of the Permanent School Fund's Financial Statements for Fiscal Year Ending August 31, 2014

(Board agenda page III-23)

Verma Elliott, audit manager, and Hillary Eckford, project manager for the PSF audit, presented the results of the annual audit of the Permanent School Fund for the year ending August 31, 2014. Ms. Elliott stated that the State Auditor's Office (SAO) issued an unqualified opinion on the financial statements audited for the period. Ms. Eckford stated that the SAO also conducted a review of internal controls and identified one internal control weakness pertaining to control between the development and production environments of the TEA ISAS accounting system. The TEA IT department implemented a software change as of the end of August 2014 which addresses this weakness and this change will be tested during the next audit cycle.

Ms. Eckford also reported that there were no uncorrected misstatements in the financial statements and that two Governmental Accounting Standards Board (GASB) statements (GASB 65 and 70) and were implemented during FY2014.

CONSENT ITEMS

7. Overview of the Real Estate Asset Class

(Board agenda page III-11)

[Consent agenda item #(4)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick, Principal/Chief Operating Officer, and Dan Moore, Senior Consultant, joined by John Grubenman, director of private markets for PSF.

Mr. Grubenman introduced the topic and discussed recommended changes to select provisions in the *Real Estate Investment Policy Statement* and the *Annual Tactical Plan*. Mr. Novick and Mr. Moore stated that Courtland concurs with the suggested changes to both the policy and the tactical plan.

Mr. Novick presented summaries for two co-investments executed by the PSF after the previous SBOE meeting. He stated that both investments were in compliance with all policy limitations.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve proposed changes to the Real Estate Investment Policy Statement and the Annual Tactical Plan.*

8. Decision on Real Estate Investments

(Board agenda page III-13)
[Consent agenda item #(5)]

The PSF real estate consultant, Courtland Partners, was represented by Mr. Novick and Mr. Moore, joined by Mr. Grubenman, director of private markets for PSF. Mr. Grubenman provided an introduction to a real estate investment recommendation.

Mr. Moore presented a recommendation of the PAG Asia Special Situations Fund II, L.P., offered by PAG Special Situations Management II Ltd., as General Partner. Mr. Moore described the due diligence process conducted by both Courtland and PSF staff, provided a brief overview including its objectives and strategy, and outlined the merits and considerations. Mr. Grubenman stated that since PAG is domiciled outside the US, the board would need to approve a waiver of the requirement for service providers to be registered with the Securities and Exchange Commission and also review and approve the manager's relationship with a placement agent.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreement(s) with PAG Special Situations Management II Ltd., necessary to make an investment commitment of up to \$50 million in PAG Asia Special Situations Fund II L.P., a U.S. dollar denominated fund, subject to continued due diligence and negotiation of fund terms, to approve the relationship between PAG Special Situations Management II Ltd. and Park Hill Group, LLC, after determining it meets the standards of 19 TAC Chapter 33, Section(j)(5), which has been disclosed in writing, and also, to approve a waiver of the PSF Real Estate Investment Policy Statement requirement for the investment manager (Pacific Alliance Investment Management Ltd.) to be a registered investment advisor with the Securities Exchange Commission.*

9. Authorization to Issue a Request for Qualifications (RFQ) for Rating Agencies for the Permanent School Fund

(Board agenda page III-15)
[Consent agenda item #(6)]

Ms. Hardy called on Carlos Veintemillas, deputy chief investment officer, to address the item. Mr. Veintemillas presented the key points relevant to the issuance of this Request for Qualifications for Rating Agency Services for the Texas Permanent School Fund and the Bond Guarantee Program.

Mr. Timmins asked Rhett Humphreys, partner with NEPC, if he had any comments for the committee related to this RFQ. He stated that none of their clients had conducted a similar process; however, the committee is taking a reasonable approach to the matter.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to issue the Request for Qualifications (RFQ) for Rating Agency Services for the Texas Permanent School Fund and the Bond Guarantee Program with amendments (Attachment B).*

10. Authorization to Issue a Request for Proposals (RFP) for Investment Counsel Services for the Permanent School Fund

(Board agenda page III-17)
[Consent agenda item #(7)]

Mr. Timmins informed the committee that the contract for investment counsel would terminate in August 2015 and could not be extended, so an RFP is required. He presented the key points relevant to the issuance of this Request for Proposals for Investment Counsel Services for the Texas Permanent School Fund.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to issue the Request for Proposals for Investment Counsel Services for the Texas Permanent School Fund.*

DISCUSSION ITEMS

11. Presentations on Investment Management Services Provided to the Permanent School Fund

(Board agenda page III-25)

Ms. Hardy called on Mr. Timmins to introduce the item to the committee.

Representatives from the following firms made presentations to the committee in which they discussed recent market conditions and provided the committee with updates on strategy and performance for the portfolios they manage for the benefit of the PSF.

Private Equity

Grosvenor Capital Management

Bernard Yancovich, Managing Director/Partner
Stephen Brewster, Managing Director
Lee Brashear, Principal

Neuberger Berman

John Buser, Managing Director
Kaci Boyer, Vice President

International Equity

BlackRock Investment Management

Timothy Murray, Director
Krishna Yarra, Analyst

12. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer

(Board agenda page III-27)

Mr. Timmins reported that there were three (3) reported disclosures of transactions between PSF service providers on the fourth quarter report but none were considered a compliance issue.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 2:25 p.m.